DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 07-0452
Indiana Adjusted Gross Income Tax
For 2006 and 2007

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The date of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Imposition of the State's Individual Income Tax.

Authority: Ind. Const. art X, § 8; IC § 6-3-1-3.5 et seq.; IC § 6-3-1-9; *New York v. Graves*, 300 U.S. 308 (1937); *Merchants' Loan Trust Company v. Smietanka*, 255 U.S. 509 (1921); *Eisner v. Macomber*, 252 U.S. 189 (1920); *Doyle v. Mitchell*, 247 U.S. 179 (1918); *Stratton's Independence v. Hobert*, 231 U.S. 399 (1913); *United States v. Connor*, 898 F2d 942 (3rd Cir. 1990); *Wilcox v. Commissioner of Internal Revenue*, 848 F2d 1007 (9th Cir. 1988); *Coleman v. Commissioner of Internal Revenue*, 791 F2d 68 (7th Cir. 1986); *United States v. Koliboski*, 732 F2d 1328 (7th Cir. 1984); *United States v. Romero*, 640 F2d 1014 (9th Cir. 1981); *Snyder v. Indiana Dept. of State Revenue*, 723 N.E.2d 487 (Ind. Tax Ct. 2000); *Thomas v. Indiana Dept. of State Revenue*, 675 N.E.2d 362 (Ind. Tax. Ct. 1997); *Richey v. Indiana Dept. of State Revenue*, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

Taxpayer argues that only corporate gain is subject to either federal or state income tax.

II. Taxpayer as "Employee" – Adjusted Gross Income Tax.

Authority: IC § 6-3-1-3.5; IC § 6-3-1-6; IC § 6-3-1-9; IC § 6-3-1-12; IC § 6-3-1-15; I.R.C. § 3401(c).

Taxpayer states that because he is not employed by either the federal government or the State of Indiana, he is not subject to Adjusted Gross Income.

III. Indiana Residents – Adjusted Gross Income Tax.

Authority: I.R.C. § 3121(e)(1); I.R.C. § 7701(c); *Brushaber v. Union Pac. R.R.*, 240 U.S. 1 (1916); *United States v. Collins*, 920 F.2d 619 (10th Cir. 1990).

Taxpayer maintains that because the term "state" as used in the Internal Revenue Code does not include Indiana, he is not subject to Adjusted Gross Income Tax.

STATEMENT OF FACTS

Taxpayer submitted state income tax returns on which he reported no taxable income. The Department of Revenue of Revenue rejected the returns, and taxpayer submitted a protest arguing that the returns were correct and that he was entitled to a refund of money his employer had withheld from his paycheck. An administrative hearing was held during which taxpayer explained the basis for his protest. This Letter of Findings results.

I. Imposition of the State's Individual Income Tax.

DISCUSSION

Taxpayer claims that the federal – and by implication, Indiana's – individual income tax is only applicable to corporate profits. Taxpayer argues that the Corporation Excise Tax Act of 1909, The U.S. Const. amend. XVI, and the Income Tax Act of 1913, 1916, and 1917 all impose a tax on the gain derived from capital or labor provided that the gain is realized from profits realized through the sale or conversion of capital assets.

Taxpayer has provided a number of Supreme Court cases which purportedly support taxpayer's contention. Taxpayer cites to *Merchants' Loan Trust Company v. Smietanka*, 255 U.S. 509 (1921) for the proposition that income tax can only be levied against corporate gains. In that case, the Court held that when a provision in a will created a trust, the increase of the value of the trust resulted in taxable "income" under the provisions of the U.S. Const. amend. XVI. *Id*. at 520. In arriving at that decision, the Court stated that "the word [income] must be given the same meaning and content in the Income Tax Acts of Congress that was given to it in the Corporation Excise Tax Act and that what that meaning is has now become definitely settled by decisions of [the] court." *Id*. at 519.

Taxpayer also cites to *Eisner v. Macomber*, 252 U.S. 189 (1920), in which the Court addressed the issue of whether the U.S. Const. amend. XVI permitted the government to tax a taxpayer's stock divided resulting from a corporation's accumulated profits. The Court held that the stock dividend did not involve the realization of a taxable gain but that the corporation's accumulated profits were simply capitalized or retained as surplus. *Id*. at 211. In effect, the taxpayer in Eisner did not realize a gain severed from and independent of the corporations' assets. *Id*. at 211-12. In reaching that decision, the Court stated that income is the "gain derived from capital, from labor, or from both combined." *Id*. at 201.

Taxpayer reads *Merchant's Loan* and *Eisner* together with certain other cases – *Doyle v. Mitchell*, 247 U.S. 179 (1918); *Stratton's Independence v. Hobert*, 231 U.S. 406 (1913) – as supporting his contention that the individual income can only be assessed against corporate gain. Taxpayer predicates this conclusion on selected case citations which, when taken together, purportedly limits the definition of "taxable income" to the definition originally established under the Civil War Income Tax Act of 1867. However, setting aside the question of the validity of taxpayer's legal analysis, taxpayer's conclusion concerning the definition of corporate income tax is ultimately irrelevant.

Taxpayer's legal analysis stands for nothing more than, when read in isolation and divorced from the factual setting under which the decisions were reached, a legal argument can be proposed which will support any legal conclusion no matter how unjustified that conclusion. Taxpayer cites cases in which the Court was asked to determine what constituted corporate income under the corporate income and excise taxes in effect at the time the Court reached its conclusion. To apply Supreme Court decisions limited to determining application of corporate income taxes to issues related to individual income tax is not legally, logically, or intellectually sound.

As set out in the Indiana Constitution, "The general assembly may levy and collect a tax upon income, from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art X, § 8. The Indiana General Assembly exercised its constitutional prerogative by imposing an adjusted gross income tax on individuals and corporations. IC § 6-3-1-3.5 et seq. In doing so, the General Assembly defined an individual subject to the adjusted gross income tax as a "natural born person, whether married or unmarried, adult or minor." IC § 6-3-1-9.

Although not binding upon the state's practice of taxing the wages of its own citizens, the United States Supreme Court has definitively ruled on the question of whether a citizen's individual income may be subjected to an adjusted gross income tax. In *New York v. Graves*, 300 U.S. 308, 312-13 (1937), Justice Stone stated as follows:

> That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from the responsibility for sharing the costs of government . . . . A tax measured by the net income of residents is an equitable method of distributing the burdens of government among those who are privileged to enjoy its benefits. The tax, which is apportioned to the ability of the taxpayer to pay it, is founded upon the protection afforded by the state to the recipient of the income in his person, in his right to receive the income and in his enjoyment of it when received. These are rights and privileges which attach to domicil within the state. To them and to the equitable distribution of the tax burden, the economic advantage realized by the receipt of income and represented by the power to control it, bears a direct relationship. Neither the privilege nor the burden is affected by the character of the source from which the income is derived.

Since that 1937 decision, the federal courts have consistently, repeatedly, and without exception, determined that individual wages are income. *United States v. Connor*, 898 F2d 942. 943 (3rd Cir. 1990) ("Every court which has ever considered the issue has unequivocally rejected the argument that wages are not income"); *Wilcox v. Commissioner of Internal Revenue*, 848 F2d 1007, 1008 (9th Cir. 1988) ("First, wages are income."); *Coleman v. Commissioner of Internal Revenue*, 791 F2d 68, 70 (7th Cir. 1986) ("Wages are income, and the tax on wages is constitutional."); *United States v. Koliboski*, 732 F2d 1328, 1329 n. 1 (7th Cir. 1984) ("Let us now put [the question] to rest: WAGES ARE INCOME. Any reading of tax cases by would-be tax protesters now should preclude a claim of good-faith belief that wages – or salaries – are not taxable") (EMPHASIS IN ORIGINAL); *United States v. Romero*, 640 F2d 1014, 1016 (9th Cir.

1981) ("Compensation for labor or services, paid in the form of wages or salary, has been universally held by the courts of this republic to be income, subject to the income tax laws currently applicable. . . . [Taxpayer] seems to have been inspired by various tax protesting groups across the land who postulate weird and illogical theories of tax avoidance all to the detriment of the common weal [sic] and of themselves.").

In addressing the identical issue, the Indiana Tax Court has held that, "Common definition, an overwhelming body of case law by the United Sates Supreme Court and federal circuit courts, and this Court's opinion . . . all support the conclusion that wages are income for purposes of Indiana's adjusted gross income tax." *Snyder v. Indiana Dept. of State Revenue*, 723 N.E.2d 487, 491 (Ind. Tax Ct. 2000). See also *Thomas v. Indiana Dept. of State Revenue*, 675 N.E.2d 362 (Ind. Tax Ct. 1997); *Richey v. Indiana Dept. of State Revenue*, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

Taxpayer's argument – that only corporate gain is subject to either federal or state income tax – is erroneous.

FINDING

Taxpayer's protest is denied.

II. Taxpayer as "Employee" – Adjusted Gross Income Tax.

DISCUSSION

Taxpayer argues that he is not an "employee" pursuant to IC § 6-3-1-6. That portion of Indiana law states that, "The term 'employee' means 'employee' as defined in section 3401(c) of the Internal Revenue Code." Taxpayer then directs the Department's attention to I.R.C. § 3401(c) which reads in full as follows:

> For purposes of this chapter, the term "employee" includes an officer, employee, or elected official of the United States, a State or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term "employee" also includes an officer of a corporation.

Taxpayer argues that because he does not fall into one of the classifications set out in I.R.C. § 3401(c), he is not required to report as income the money he receives from the private, non-governmental entity for which he works. Taxpayer's protest letter states that, "One who is not a citizen, resident, or non-resident alien, is not an individual subject to the tax imposed by Section 1 of the Internal Revenue Code." Taxpayer also states that, "[I]t is a violation of due process and a violation of delegated authority for any IRS tax official to refer to any person as a 'taxpayer' who does not first identify him or herself as such *voluntarily*." (*Emphasis in original*).

The "chapter" referred to in I.R.C. § 3401(c) is the portion of the Internal Revenue Code entitled "Withholding from Wages." Persons who work for the United States government, work for the District of Columbia, or are corporate officers are required to have income tax periodically

withheld from their paychecks. IC § 6-3-1-6 "piggy-backs" on that federal provision and – for purposes of the Indiana tax – also requires those same persons to have state income tax payments withheld from their paychecks.

Presumably, taxpayer's argument is that only federal employees, District of Columbia residents, and corporate officers are subject to federal and Indiana income tax. The two statutory provisions – I.R.C. § 3401(c) and IC § 6-3-1-6 – are intended to bring certain, specified employers within federal and state *withholding* requirements. The federal government, employers of persons who live in the District Columbia, and corporations who pay corporate officers are required to *withhold* income tax from the paychecks issued to these three particular classifications of employees. There is nothing I.R.C. § 3401(c) or IC § 6-3-1-6 which indicates that *only* these three categories of employees are required to pay federal and state income tax.

As stated in IC § 6-3-1-3.5, "When used in this article, the term 'adjusted gross income" shall mean the following . . . in the case of all *individuals* 'adjusted gross income' as defined in Section 62 of the Internal Revenue Code . . . ." (*Emphasis added*). IC 6-3-1-9 states that, "The term 'individual' means a natural person, whether married or unmarried, adult or minor." Despite taxpayer's assertions that he somehow stands outside the taxing authority of the state, given that taxpayer had taxable income, is an "individual" as defined by IC § 6-3-1-0, was a resident of Indiana for the years at issue (IC § 6-3-1-12), and is a "taxpayer" as defined within IC § 6-3-1-15, the statutes imposing the individual income tax apply with full force to taxpayer's wages.

FINDING

Taxpayer's protest is denied.

III. Indiana Residents – Adjusted Gross Income Tax.

DISCUSSION

Taxpayer maintains that the Indiana is not one of the jurisdictions included in the Internal Revenue Code's definition of "state." Taxpayer cites to I.R.C. § 3121(e)(1), which states that, "The term 'State' includes the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa."

Taxpayer points to this portion of the Internal Revenue code as standing for the proposition that the term "states" includes neither Indiana nor the other 49 states of the Union.

However, taxpayer overlooks I.R.C. § 7701(c) which states that, "The terms 'includes' and 'including' when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined."

I.R.C. § 3121(e)(1) is written to bring certain, particularized jurisdictions with the purview of the Internal Review Code. Taxpayer reads this is a "limiting" provision circumscribing the reach of federal taxing jurisdiction. Taxpayer's interpretation represents a strained interpretation of the federal code and would come as something of a surprise to the millions of United States residents

outside of "District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa" who regularly pay their federal and state income tax as required by law. I.R.C. § 7701(c) specifically refutes the attenuated interpretation forwarded by taxpayer and for ninety years, the Supreme Court has recognized that the Sixteenth Amendment authorizes a direct nonapportioned tax upon United States citizens throughout the nation, not just in federal enclaves. *Brushaber v. Union Pac. R.R.*, 240 U.S. 1, 12-19 (1916); *See also United States v. Collins*, 920 F.2d 619, 629 (10th Cir. 1990) (Rejecting the "hackneyed tax protester refrain that federal criminal jurisdiction only extends to the District of Columbia, United States territorial possessions and ceded territories.")

FINDING

Taxpayer's protest is denied.

Taxpayer raises other objections including the charge that the Department is acting outside its constitutional authority in conducting administrative hearings on tax matters and that Sixteenth Amendment to the United States Constitution was "fraudulently certified." Taxpayer's arguments are meritless, and the Department will not expend its limited resources addressing them.

DK/JR/BK – October 5, 2007.